Story County Hospital and Long-Term Care Facility

Accountants' Report and Financial Statements

June 30, 2006 and 2005

Story County Hospital and Long-Term Care Facility

June 30, 2006 and 2005

Contents

Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Story County Hospital and Long-Term Care Facility
Nevada, Iowa

We have audited the accompanying balance sheet of Story County Hospital and Long-Term Care Facility as of June 30, 2006, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statement of Story County Hospital and Long-Term Care Facility as of and for the year ended June 30, 2005, were audited by other accountants whose report dated August 26, 2005, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of Story County Hospital and Long-Term Care Facility as of June 30, 2006, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 1, 2006, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We and the other accountants have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information in 2006 and 2005, respectively. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Hospital's basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The supplemental information as of and for the year ended June 30, 2005, was audited by other accountants whose report dated September 14, 2005, expressed an unqualified opinion on such information in relation to the basic financial statements as of and for the year ended June 30, 2005, taken as a whole.

/s/ **BKD, LLP**

Kansas City, Missouri
September 1, 2006

Story County Hospital and Long-Term Care Facility
Management's Discussion and Analysis
Years Ended June 30, 2006 and 2005

Introduction

This management's discussion and analysis of the financial performance of Story County Hospital and Long-Term Care Facility and Story County Hospital Foundation (collectively referred to as the "Hospital") provides an overview of the Hospital's financial activities for the years ended June 30, 2006 and 2005. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and cash equivalents decreased between 2006 and 2005 by $193,836 or 27%, decreased between 2005 and 2004 by $18,536 or 3%.
- The Hospital's net assets increased $398,511 or 13% in 2006, decreased $161,419 or 5% in 2005 and increased $617,389 or 22% in 2004.
- The Hospital reported an operating loss in 2006 of $607,254, 2005 of $1,104,787 and $348,904 in 2004. The operating loss in 2006 decreased by $497,533 compared to the operating loss reported in 2005, the loss in 2005 increased by $755,883 compared to the operating loss reported in 2004.
- Net nonoperating revenues increased by $27,397 or 3% in 2006 compared to 2005, decreased by $37,925 or 6% in 2005 compared to 2004.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets (the difference between assets and liabilities) are one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet. The Hospital's net assets increased by $398,511 or 13% in 2006 over 2005 as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2006	2005	2004
Assets			
Patient accounts receivable, net	$ 1,666,733	$ 1,473,030	$ 1,671,528
Other current assets	2,032,206	2,066,530	2,010,209
Capital assets, net	4,287,874	3,642,172	3,208,494
Other noncurrent assets	114,569	41,748	54,984
Total assets	$ 8,101,382	$ 7,223,480	$ 6,945,215
Liabilities			
Current liabilities	$ 2,400,885	$ 2,866,588	$ 2,286,073
Long-term debt	2,023,339	1,196,528	1,338,144
Other liabilities	123,011	4,728	3,943
Total liabilities	4,547,235	4,067,844	3,628,160
Net Assets			
Invested in capital assets, net of related debt	3,112,253	2,318,644	1,764,350
Restricted expendable	77,387	37,020	51,041
Unrestricted	364,507	799,972	1,501,664
Total net assets	3,554,147	3,155,636	3,317,055
Total liabilities and net assets	$ 8,101,382	$ 7,223,480	$ 6,945,215

A significant change in the Hospital's assets in 2006 is patient accounts receivable, which increased $193,703 or 13%. Most of this change is a result of increase in patient volumes in a number of departments such as; radiology procedures in 2005 were 2,317 compared to 3,153 in 2006, emergency room visits increased to 1,908 in 2006 compared to 1,518. Also, 75% of the gross aged accounts receivable can be found in accounts 60 days old or less while in 2005 only 44% of aged accounts receivable were 60 days or less.

Net capital assets increased in 2006 by $645,702 or 18% due to the addition of a few major capital items during fiscal year 2006, which included a CT Room, Emergency Generator and replacement of an aging Nurse Call System.

In 2005, a significant change in the Hospital's assets was due in part to the increase in net capital assets of $433,678 or 13%. During 2005, the Hospital purchased $815,006 of new assets and retired assets totaling $915,531. In addition, the Hospital had an increase in property taxes receivable for fiscal 2005 of $43,313 or 4.5%.

Operating Results and Changes in the Hospital's Net Assets

In 2006, the Hospital's net assets increased by $398,511 or 13% as shown in Table 2. This increase is made up of several different components and represents an increase of $559,930 over 2005 as compared to the decrease in net assets of $778,808 from 2004 to 2005.

Table 2: Operating Results and Changes in Net Assets

	2006	2005	2004
Operating Revenues			
Net patient service revenue	$ 11,202,622	$ 10,295,716	$ 10,775,317
Other operating revenues	140,191	118,411	126,142
Total operating revenues	11,342,813	10,414,127	10,901,459
Operating Expenses			
Salaries and wages and employee benefits	6,923,269	6,879,300	6,344,710
Medical and professional fees	1,406,154	1,403,783	1,434,129
Depreciation and amortization	500,842	381,328	426,835
Other operating expenses	3,119,802	2,854,503	3,044,689
Total operating expenses	11,950,067	11,518,914	11,250,363
Operating Loss	(607,254)	(1,104,787)	(348,904)
Nonoperating Revenues (Expenses)			
Property taxes	990,990	963,409	1,004,052
Interest income	3,564	4,264	1,412
Non-capital grants and gifts	32,925	33,768	63,714
Other	29,393	2,705	740
Interest expense	(101,107)	(75,778)	(103,625)
Total nonoperating revenues	955,765	928,368	966,293
Capital Grants and Contributions	50,000	15,000	—
Increase (Decrease) in Net Assets	$ 398,511	$ (161,419)	$ 617,389

Operating Loss

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In 2006, 2005 and 2004, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Story County and the surrounding area. The Hospital levies property taxes to provide sufficient resources to enable the facility to serve patients.

The operating loss for 2006 decreased by $497,533 or 48% as compared to 2005. The primary components of the decreased operating loss are:

- Net patient service revenues, before provision for uncollectible accounts, increased $1,023,358 or 10% during fiscal year 2006. Most of the increase was found in outpatient hospital revenues and medical clinic revenues. The Hospital experienced significant growth in some outpatient services such as radiology procedures, emergency room visits, ambulance runs and operating room visits lending to increases in gross revenues.

- Growth in expenses was limited, total annual expenses increased by $431,153 or 4% overall. The majority of the growth in expenses was due to the increase in supplies and other, which is related to the increase in volume during 2006.

The operating loss for 2005 was $161,419, which was a decrease of $778,808 as compared to the operating income of $617,389 shown in 2004. The primary components of the 2005 operating loss are:

- Net patient revenues decreased by $479,601 or 4% during 2005 due to volume reductions in some service lines and a sizeable increase in contractual allowances due to changes in Medicaid rates during the year.

- Expenses increased by $268,551 or 2% during 2005 primarily due to salary and employee benefit expenses increasing $534,590 or 8%. The increase in salaries was partially offset by a decrease in other operating expenses of $190,186 or 6%.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of property taxes levied by the Hospital, interest income and interest expense, and grants, all of which remained relatively constant in 2006 as compared to 2005 and 2004.

Non-Capital Gifts and Grants

The Hospital received non-capital gifts and grants of $32,925, $33,768 and $63,714 from various sources in 2006, 2005 and 2004. The decrease in non-capital gifts and grants totaled $843 or 2% in 2005 and $29,946 or 47% in 2004.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in the operating loss and nonoperating revenues and expenses in 2006 and 2005 as discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2006, the Hospital had $4,287,874 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2006, the Hospital purchased new capital assets costing $1,146,544. Of this amount, $374,958 was acquired through the incursion of capital lease obligations.

In 2005 and 2004, the Hospital purchased new capital assets costing $815,006 and $248,747, respectively, of which $80,066 was included in accounts payable in 2005 and $73,159 was financed through long-term debt in 2004.

Debt

At June 30, 2006 and 2005, the Hospital had $2,262,645 and $1,323,528 in notes payable and capital lease obligations outstanding, respectively. The Hospital initiated a note payable of $479,542 and a capital lease of $374,958 in 2006. The Hospital issued no new debt in 2005. The Hospital initiated a note payable of $73,159 in 2004.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Administration by calling (515) 462-2373.

Story County Hospital and Long-Term Care Facility

Balance Sheets

June 30, 2006 and 2005

Assets

	2006	2005
Current Assets		
Cash and cash equivalents	$ 526,638	$ 720,474
Patient accounts receivable, net of allowance; 2006 – $273,781, 2005 – $235,412	1,666,733	1,473,030
Property taxes receivable	1,194,078	989,152
Other receivables	24,901	23,916
Supplies	230,032	233,281
Prepaid expenses	56,557	85,207
Total current assets	3,698,939	3,525,060
Noncurrent Cash and Deposits		
Resident trust agreement	8,010	4,728
Externally restricted by donors	37,387	37,020
Foundation assets	69,172	—
	114,569	41,748
Capital Assets, net	4,287,874	3,642,172
Other Assets		
Other investments	—	14,500
Total Assets	$ 8,101,382	$ 7,223,480

Liabilities and Net Assets

		2006		2005
Current Liabilities				
Current maturities of long-term debt	$	239,306	$	127,000
Line of credit		—		336,410
Accounts payable		323,195		419,979
Accrued expenses		568,191		687,887
Estimated amounts due to third-party payers		191,116		306,160
Deferred revenue for property taxes		1,194,078		989,152
Total current liabilities		2,515,886		2,866,588
Long-term Debt		2,023,339		1,196,528
Other Long-term Liabilities				
Resident trust fund		8,010		4,728
Total liabilities		4,547,235		4,067,844
Net Assets				
Invested in capital assets, net of related debt		3,112,253		2,318,644
Restricted				
By contributors and grantors		77,387		37,020
Unrestricted		364,507		799,972
Total net assets		3,554,147		3,155,636
Total Liabilities and Net Assets	$	8,101,382	$	7,223,480

Story County Hospital and Long-Term Care Facility

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended June 30, 2006 and 2005

	2006	2005
Operating Revenues		
Net patient service revenue before provision for uncollectible accounts	$ 11,754,276	$ 10,730,918
Provision for uncollectible accounts	(551,654)	(435,202)
Net patient service revenue	11,202,622	10,295,716
Other	140,191	118,411
Total operating revenues	11,342,813	10,414,127
Operating Expenses		
Salaries and wages	5,716,411	5,613,415
Employee benefits	1,206,858	1,265,885
Medical professional fees	1,406,154	1,403,783
Insurance	193,408	204,526
Supplies and other	2,926,394	2,649,977
Depreciation and amortization	500,842	381,328
Total operating expenses	11,950,067	11,518,914
Operating Loss	(607,254)	(1,104,787)
Nonoperating Revenues (Expenses)		
Property taxes	990,990	963,409
Interest income	3,564	4,264
Noncapital grants and gifts	62,097	33,768
Other	221	2,705
Interest	(101,107)	(75,778)
Total nonoperating revenues	955,765	928,368
Excess (Deficiency) of Revenues Over Expenses Before Capital Grants and Gifts	348,511	(176,419)
Capital Grants and Gifts	50,000	15,000
Increase (Decrease) in Net Assets	398,511	(161,419)
Net Assets, Beginning of Year	3,155,636	3,317,055
Net Assets, End of Year	$ 3,554,147	$ 3,155,636

Story County Hospital and Long-Term Care Facility

Statements of Cash Flows

Years Ended June 30, 2006 and 2005

	2006	2005
Operating Activities		
Receipts from and on behalf of patients	$ 10,893,875	$ 10,409,239
Payments to and on behalf of employees	(7,042,965)	(6,765,403)
Payments to suppliers and contractors	(4,510,775)	(4,215,984)
Other receipts, net	69,667	129,390
Net cash used in operating activities	(590,198)	(442,758)
Noncapital Financing Activities		
Property taxes	990,990	963,409
Noncapital grants and gifts	62,097	36,473
Other	221	—
Net cash provided by noncapital financing activities	1,053,308	999,882
Capital and Related Financing Activities		
Principal paid on capital debt and leases	(251,793)	(120,616)
Interest paid on capital debt and leases	(101,107)	(75,778)
Proceeds from debt	479,542	336,410
Purchase of capital assets	(851,652)	(734,940)
Capital gifts	50,000	15,000
Net cash used in capital and related financing activities	(675,010)	(579,924)
Investing Activities		
Interest on deposits	3,564	4,264
Proceeds from disposition of deposits	14,500	—
Net cash provided by investing activities	18,064	4,264
Decrease in Cash and Cash Equivalents	(193,836)	(18,536)
Cash and Cash Equivalents, Beginning of Year	720,474	739,010
Cash and Cash Equivalents, End of Year	$ 526,638	$ 720,474

(Continued)

Story County Hospital and Long-Term Care Facility
Statements of Cash Flows
Years Ended June 30, 2006 and 2005

	2006	2005
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used in Operating Activities		
Operating loss	(607,254)	(1,104,787)
Depreciation and amortization	500,842	381,328
Changes in operating assets and liabilities		
Patient accounts receivable, net	(193,703)	198,498
Other receivables	(985)	(3,042)
Supplies	3,249	(22,666)
Prepaid expenses	(44,171)	7,400
Estimated amounts due from and to third-party payers	(115,044)	(84,975)
Accounts payable and accrued expenses	(133,132)	185,486
Net cash used in operating activities	$ (590,198)	$ (442,758)
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	$ 374,958	$ —
Capital acquisitions included in accounts payable	—	80,066

Story County Hospital and Long-Term Care Facility
Notes to Financial Statements
June 30, 2006 and 2005

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Story County Hospital and Long-Term Care Facility is a county public hospital organized and operated under Chapter 347 of the Code of Iowa. The Board of Trustees is elected by voters of Story County. The Hospital primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in the Story County area.

Story County Hospital Foundation (Foundation) is included in Story County Hospital and Long-Term Care Facility's financial statements as a blended component unit. The Foundation is legally separate from Story County Hospital and Long-Term Care Facility, but was organized primarily for its benefit. Story County Hospital and Long-Term Care Facility and the Foundation are collectively referred to as the "Hospital" throughout this report.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program-specific (such as county appropriations), property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2006 and 2005, cash equivalents consisted primarily of money market accounts.

Property Taxes

The Hospital received approximately 8.74% and 9.25% of its financial support from property tax revenues in the years ended June 30, 2006 and 2005, respectively, which were used to support operations. The Hospital levies the tax in March of each year based on assessed valuation of property in Story County as of the second preceding January 1. Tax bills are sent by the County in August and the taxes are payable half on September 1 and March 1, and become delinquent after October 1 and April 1, respectively.

Property tax receivable is recognized on the levy or lien date, which is the date that the tax asking is certified by the County Board of Supervisors. The succeeding property tax receivable represents taxes certified by the Board of Supervisors to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. By statute, the Board of Supervisors is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, vision, short-term disability and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than those related to employee health, dental, vision and short-term disability claims, for which the Hospital is self-insured. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	10 to 25 years
Buildings, improvements and fixed equipment	5 to 40 years
Major moveable equipment	3 to 20 years

Compensated Absences

Hospital policies permit most employees to accumulate paid time off benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable net assets.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and include estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were $235,201 and $188,573 for 2006 and 2005, respectively.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation. The reclassifications had no effect on the results of operations.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

- **Medicare.** Inpatient and outpatient services and defined capital cost related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Fiscal Intermediary. Estimated settlements have been reflected in the accompanying financial statements.

- **Medicaid.** Inpatient and outpatient services rendered to Medicaid Program beneficiaries were reimbursed based upon a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with the final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid Program.

Approximately 58% and 51% of net patient service revenues are from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2006 and 2005, respectively.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits, Investments and Interest Income

Deposits

Custodial credit risk is the risk that, in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial risk requires compliance with the provisions of state law.

The Hospital had no bank balances exposed to custodial credit risk at June 30, 2006 and 2005. The Hospital's deposits in banks at June 30, 2006 and 2005 were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Investments

The Hospital is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts, and warrants or improvement certificates of a drainage district. The Hospital had no investments at June 30, 2006 and 2005.

Summary of Carrying Values

The carrying values of deposits are included in the balance sheets as follows:

	2006	2005
Carrying value		
Deposits	$ 641,207	$ 762,222
Included in the following balance sheet captions		
Cash and cash equivalents	$ 526,638	$ 720,474
Assets held under trust agreement	8,010	4,728
Assets restricted by donors	37,387	37,020
Foundation assets	69,172	—
	$ 641,207	$ 762,222

Interest Income

Interest income for the years ended June 30, 2006 and 2005, amounted to $3,564 and $4,264, respectively.

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at June 30, 2006 and 2005 consisted of:

	2006	2005
Medicare	$ 549,472	$ 366,697
Medicaid	353,202	396,390
Other third-party payers	654,457	471,761
Patients	383,383	473,594
	1,940,514	1,708,442
Less allowance for uncollectible accounts	273,781	235,412
	$ 1,666,733	$ 1,473,030

Note 5: Capital Assets

Capital assets activity for the years ended June 30, 2006 and 2005 follows:

	Beginning Balance	Additions	Disposals	Transfers/ Adjustments	Ending Balance
2006					
Land	$ 52,176	$ —	$ —	$ —	$ 52,176
Land improvements	97,523	—	—	—	97,523
Buildings and leasehold improvements	4,923,087	—	—	13,357	4,936,444
Fixed equipment	1,446,714	98,524	—	646,337	2,191,575
Major movable equipment	2,288,894	33,798	—	40,570	2,363,262
Equipment under capital lease	—	374,958	—	—	374,958
Construction in progress	135,549	639,264	—	(700,264)	74,549
	8,943,943	1,146,544	—	—	10,090,487
Less accumulated depreciation					
Land improvements	52,704	5,699	—	—	58,403
Buildings and leasehold improvements	2,779,914	149,715	—	—	2,929,629
Fixed equipment	814,093	112,708	—	—	926,801
Major movable equipment	1,655,060	157,729	—	—	1,812,789
Equipment under capital lease	—	74,991	—	—	74,991
	5,301,771	500,842	—	—	5,802,613
Capital assets, net	$ 3,642,172	$ 645,702	$ —	$ —	$ 4,287,874

	Beginning Balance	Additions	Disposals	Transfers/ Adjustments	Ending Balance
2005					
Land	$ 52,176	$ —	$ —	$ —	$ 52,176
Land improvements	72,690	24,833	—	—	97,523
Buildings and leasehold improvements	4,768,355	61,532	(5,835)	99,035	4,923,087
Fixed equipment	1,548,768	335,172	(250,000)	(187,226)	1,446,714
Major movable equipment	2,602,479	257,920	(253,830)	(317,675)	2,288,894
Construction in progress	—	135,549	—	—	135,549
	9,044,468	815,006	(509,665)	(405,866)	8,943,943
Less accumulated depreciation					
Land improvements	49,298	3,406	—	—	52,704
Buildings and leasehold improvements	2,634,095	151,654	(5,835)	—	2,779,914
Fixed equipment	1,094,316	57,967	(250,000)	(88,190)	814,093
Major movable equipment	2,058,265	168,301	(253,830)	(317,676)	1,655,060
	5,835,974	381,328	(509,665)	(405,866)	5,301,771
Capital assets, net	$ 3,208,494	$ 433,678	$ —	$ —	$ 3,642,172

Note 6: Medical Malpractice Insurance

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made.

Note 7: Line of Credit

During 2005, the Hospital was approved for an $800,000 line of credit for the purpose of purchasing new equipment. As of June 30, 2005, the Hospital had drawn $336,410 of the line of credit for the purchase of equipment. The line of credit matured on July 6, 2005, and was extended to July 6, 2006. Interest was paid monthly on the line of credit and totaled to $27,367 and $2,670 during 2006 and 2005, respectively. Subsequent to year end June 30, 2006, the Hospital converted the line of credit to a note payable. Therefore, the note payable is shown with the long-term obligations.

Note 8: Long-term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended June 30, 2006 and 2005:

			2006		
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Note payable F&M Bank (A)	$ 46,598	$ —	$ (31,760)	$ 14,838	$ 14,838
Note payable U.S. Bank (B)	185,714	—	(19,620)	166,094	20,555
Note payable State Bank & Trust – MOB (C)	1,091,216	—	(96,527)	994,689	101,614
Note payable State Bank & Trust (D)	336,410	479,542	(33,851)	782,101	30,672
Capital lease obligations (E)	—	374,958	(70,035)	304,923	71,627
Total long-term debt	$ 1,659,938	$ 854,500	$ (251,793)	$ 2,262,645	$ 239,306

	2005				
	Beginning Balance	**Additions**	**Deductions**	**Ending Balance**	**Current Portion**
Long-term debt					
Note payable F&M Bank (A)	$ 75,966	$ —	$ (29,368)	$ 46,598	$ 31,000
Note payable U.S. Bank (B)	204,289	—	(18,575)	185,714	19,000
Note payable State Bank and Trust (C)	1,163,889	—	(72,673)	1,091,216	77,000
Total long-term debt	$ 1,444,144	$ —	$ (120,616)	$ 1,323,528	$ 127,000

(A) The note payable to F&M Bank requires a semi-annual payment of principal and interest with interest at the rate of 4.52%. Principal and interest payments are due through November 2006. The note is secured by equipment.

(B) The note payable to U.S. Bank is a construction loan with a limit of $275,000. The note requires monthly interest payments during the construction period with interest at the rate of 4.99%.

(C) The note payable to State Bank and Trust requires a semi-annual payment of principal and interest with interest at the rate of 4.85%. Principal and interest payments are due through May 2015. The note was for the construction of the new medical office building.

(D) The line of credit agreement with State Bank and Trust was converted to a note payable August 15, 2006. This note requires monthly principal and interest payments with interest at the rate of 4.85%. Principal and interest payments are due through August 2016.

(E) The Hospital entered into a capital lease arrangement for a CT Scanner on July 28, 2005. The lease requires monthly payments of principal and interest through June, 2010 and has an effective interest rate of 4.09%.

Aggregate future payments of principal and interest on the long-term debt obligations are as follows:

Year Ending June 30,	Total to be Paid	Principal	Interest
2007	$ 336,624	$ 239,306	$ 97,318
2008	334,370	241,389	92,981
2009	334,370	252,846	81,524
2010	334,371	264,852	69,519
2011	251,605	193,096	58,509
2012 – 2016	900,854	744,672	156,182
2017 – 2021	329,287	326,484	2,803
	$ 2,821,481	$ 2,262,645	$ 558,836

Note 9: Deferred Compensation Agreements

The Hospital has entered into deferred compensation agreements with certain employees, which provide that a portion of their compensation will be deferred, to be paid upon retirement or at specified dates. The agreement indicates the amounts due the employees will be the amounts deferred plus or minus earnings or losses realized on the investments of the funds at the time payment is to be made.

The provisions of the Internal Revenue Code section 457 were amended to enable plans to hold all assets and income of the plan in a trust for the exclusive benefit of participants and their beneficiaries. These assets were previously required to be held as property of the Hospital. The Hospital plan has been amended to hold the plan assets in trust for the plan participants and their beneficiaries.

The agreements are funded with various mutual fund investments, stated at fair market value. The fair market value of the plan was $502,170 and $442,863 at June 30, 2006 and 2005, respectively.

The assets included in the deferred compensation agreements are not included in these financial statements.

Note 10: Defined Benefit Pension Plan

Plan Description

The Hospital contributes to the Iowa Public Employees' Retirement System (IPERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. Pension expense is recorded for the amount the Hospital is contractually required to contribute for the year.

The plan provides retirement and death benefits, which are established by state statute, to plan members and beneficiaries. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the plan at IPERS, P. O. Box 9117, Des Moines, Iowa 50306-9117.

Funding Policy

Plan members are required to contribute 3.7% of their annual covered salaries and the Hospital is required to contribute 5.75% of annual covered payroll for 2006 and 2005. Contribution requirements are established by state statute. The Hospital's contributions to the plan for 2006, 2005 and 2004 were $329,000, $334,000 and $292,000, respectively, which equaled the required contributions for each year.

Note 11: Budget and Budgetary Accounting

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on a cash basis following required public notice and hearings for all funds. The annual budget may be amended during the year utilizing similar statutorily-prescribed procedures.

The following is a reconciliation of Story County Hospital and Long-Term Care Facility's reported amounts and their cash basis presentation as well as a comparison to budget, for the year ended June 30, 2006, excluding the Story County Hospital Foundation:

	Actual	Accrual Adjustments	Cash Basis	Budget
Revenues				
Amount to be raised by taxation	$ 990,990	$ —	$ 990,990	$ 989,152
Other revenues/receipts	11,931,177	(308,747)	11,622,430	12,270,597
Total revenues	12,922,167	(308,747)	12,613,420	13,259,749
Less expenses/disbursements	12,602,828	299,582	12,902,410	13,127,999
Change in net assets	319,339	(608,329)	(288,990)	131,750
Net assets, beginning of year	3,155,636	(1,385,832)	1,769,804	3,155,636
Net assets, end of year	$ 3,474,975	$ (1,994,161)	$ 1,480,814	$ 3,287,386

Supplementary Information

Story County Hospital and Long-Term Care Facility

Schedules of Patient Service Revenues

Years Ended June 30, 2006 and 2005

	2006				2005			
	Total	Inpatient	Outpatient	LTC	Total	Inpatient	Outpatient	LTC
Daily Patient Services								
Medical and surgical	$ 398,165	$ 299,700	$ 98,465	$ —	$ 293,841	$ 205,564	$ 88,277	$ —
Swing bed	672,498	672,498	—	—	691,235	691,235	—	—
Long term care	2,539,391	—	—	2,539,391	2,652,866	—	—	2,652,866
	3,610,054	972,198	98,465	2,539,391	3,637,942	896,799	88,277	2,652,866
Other Professional Services								
Operating and recovery room	974,790	170,382	804,408	—	787,948	130,993	656,955	—
Anesthesiology	441,012	80,405	360,607	—	376,882	50,775	326,107	—
Radiology	1,290,456	100,630	1,189,826	—	788,882	67,384	721,498	—
Laboratory	1,747,161	235,979	1,511,182	—	1,345,576	173,458	1,172,118	—
Respiratory therapy	85,597	78,669	6,928	—	95,124	88,678	6,446	—
Physical therapy	1,308,554	314,520	994,034	—	1,190,052	298,371	891,681	—
Occupational therapy	286,032	119,426	166,606	—	243,088	110,949	132,139	—
Speech therapy	12,761	6,488	6,273	—	8,834	3,649	5,185	—
Electrocardiology	78,672	3,824	74,848	—	75,591	2,549	73,042	—
Medical and surgical supplies	1,088,808	541,909	494,259	52,640	905,833	447,768	389,186	68,879
Pharmacy	1,255,804	571,355	413,601	270,848	1,108,150	470,241	336,750	301,159
Clinic	1,579,748	—	1,579,748	—	1,276,040	—	1,276,040	—
Emergency room	548,554	4,372	544,182	—	390,469	3,814	386,655	—
Ambulance	504,851	—	504,851	—	408,436	—	408,436	—
Psychologist	—	—	—	—	6,622	—	6,622	—
Acupuncture	90,928	—	90,928	—	96,159	—	96,159	—
Wellness center	45,053	—	45,053	—	39,456	—	39,456	—
	11,338,781	2,227,959	8,787,334	323,488	9,143,142	1,848,629	6,924,475	370,038
Gross Patient Service Revenue	14,948,835	$ 3,200,157	$ 8,885,799	$ 2,862,879	12,781,084	$ 2,745,428	$ 7,012,752	$ 3,022,904
Contractual Adjustments	3,194,559				2,050,166			
Net Patient Service Revenue before Provision for Uncollectible Accounts	11,754,276				10,730,918			
Provision for Uncollectible Accounts	551,654				435,202			
Net Patient Service Revenue	$ 11,202,622				$ 10,295,716			

Story County Hospital and Long-Term Care Facility

Schedules of Other Revenues

Years Ended June 30, 2006 and 2005

	2006	2005
Meals sold	$ 26,800	$ 29,321
Meals on wheels	19,168	18,429
Dietary consulting	12,342	9,892
Medical records transcripts	568	2,817
Social service consulting	3,207	6,112
Miscellaneous	78,106	51,840
	$ 140,191	$ 118,411

Story County Hospital and Long-Term Care Facility

Schedules of Operating Expenses

Years Ended June 30, 2006 and 2005

	2006			2005		
	Total	Salaries	Other	Total	Salaries	Other
Nursing Services						
Nursing administration	$ 117,249	$ 110,056	$ 7,193	$ 87,883	$ 56,020	$ 31,863
Adults and pediatrics	890,828	736,177	154,651	853,697	732,454	121,243
Operating room	274,146	182,372	91,774	271,590	166,055	105,535
Emergency	385,164	85,672	299,492	385,669	62,378	323,291
	1,667,387	1,114,277	553,110	1,598,839	1,016,907	581,932
Other Professional Services						
Central supply	362,474	47,952	314,522	252,867	48,158	204,709
Medical records	126,430	98,479	27,951	96,310	82,563	13,747
Social service	106,388	105,330	1,058	98,880	96,866	2,014
Long-term care	1,296,956	1,189,973	106,983	1,507,309	1,338,585	168,724
Anesthesiology	149,040	—	149,040	125,438	—	125,438
Radiology	330,050	162,124	167,926	357,353	143,892	213,461
Laboratory	481,076	239,814	241,262	463,945	237,303	226,642
Respiratory therapy	29,870	12,480	17,390	26,825	12,480	14,345
Physical therapy	522,844	—	522,844	479,099	—	479,099
Occupational therapy	106,240	—	106,240	92,695	—	92,695
Speech pathology	10,516	—	10,516	8,229	—	8,229
Electrocardiology	42,358	35,305	7,053	36,301	31,569	4,732
Pharmacy	579,734	32,833	546,901	515,054	24,192	490,862
Zearing clinic	238,693	194,728	43,965	221,741	169,462	52,279
Nevada clinic	1,070,439	956,079	114,360	1,004,745	921,283	83,462
Maxwell clinic	159,220	123,495	35,725	146,799	107,632	39,167
Slater clinic	110,851	88,162	22,689	105,653	52,145	53,508
After-hours clinic	—	—	—	1,294	1,294	—
Ambulance	276,878	220,116	56,762	241,317	196,414	44,903
Wellness center	133,266	121,245	12,021	142,464	111,819	30,645
Psychologist	1,433	78	1,355	2,890	133	2,757
Acupuncture	76,781	52,315	24,466	73,845	51,079	22,766
	6,211,537	3,680,508	2,531,029	6,001,053	3,626,869	2,374,184
General Services						
Operation of plant	184,315	137,177	47,138	209,663	136,691	72,972
Laundry and linen	47,634	40,655	6,979	86,360	31,703	54,657
Housekeeping	235,450	197,060	38,390	225,265	189,668	35,597
Dietary	519,710	295,173	224,537	508,617	294,156	214,461
	987,109	670,065	317,044	1,029,905	652,218	377,687
Administrative Services	1,182,926	251,561	931,365	1,037,378	317,421	719,957
Employee Benefits	1,206,858	—	1,206,858	1,265,885	—	1,265,885
Depreciation	500,842	—	500,842	381,328	—	381,328
Insurance	193,408	—	193,408	204,526	—	204,526
	$ 11,950,067	$ 5,716,411	$ 6,233,656	$ 11,518,914	$ 5,613,415	$ 5,905,499

Story County Hospital and Long-Term Care Facility

Schedules of Patient Receivables and Allowance for Uncollectible Accounts

Years Ended June 30, 2006 and 2005

Schedules of Patient Receivables

	Amounts		Percent to Total	
	2006	2005	2006	2005
Days Since Discharge				
0 – 30	$ 1,502,092	$ 1,115,457	65%	57%
31 – 60	210,360	214,976	9	11
61 – 90	175,114	100,263	8	5
91 – 120	76,167	90,898	6	5
Over four months	341,061	447,584	15	23
	2,304,794	1,969,178	100%	100%
Less contractual allowances	364,280	260,736		
	1,940,514	1,708,442		
Less allowance for uncollectible accounts	273,781	235,412		
	$ 1,666,733	$ 1,473,030		

Allowance for Uncollectible Accounts

	2006	2005
Balance, beginning of year	$ 235,412	$ 306,903
Provision for year	551,654	435,202
Recoveries of accounts previously written off	57,469	25,672
	844,535	767,777
Less accounts written off	570,754	532,365
Balance, end of year	$ 273,781	$ 235,412

Story County Hospital and Long-Term Care Facility

Schedules of Supplies and Prepaid Expense

Years Ended June 30, 2006 and 2005

Supplies

	2006	2005
Central stores	$ 39,550	$ 48,395
Pharmacy	70,564	72,072
Laboratory	55,055	47,746
Dietary	17,364	15,768
Operating room	32,453	30,374
Emergency room	1,860	1,494
Radiology	4,607	7,793
Other	8,579	9,639
	$ 230,032	$ 233,281

Prepaid Expense

	2006	2005
Insurance	$ —	$ 43,845
Maintenance and other	56,557	41,362
	$ 56,557	$ 85,207

Story County Hospital and Long-Term Care Facility
Schedule of Officials
Year Ended June 30, 2006

Name	Title	Term Expires
	Board of Trustees	
David Anderson	Chairman	2008
James Axline	Vice Chairman	2006
William Tufford	Secretary/Treasurer	2006
Glenda Bradshaw	Member	2010
Michael Nusbaum	Member	2010
Gaylan Scofield	Member	2010
Med Tait	Member	2008
	Hospital Officials	
Todd Willert	Chief Executive Officer	
Maggie Hamilton-Beyer	Chief Financial Officer	

Story County Hospital and Long-Term Care Facility

Schedules of Financial and Statistical Data

Years Ended June 30, 2006 and 2005

	2006	2005
Patient Days (Exclusive of Swing-bed)		
Medicare	342	292
Medicaid	33	26
Private and other	137	56
	512	374
Medicare and Medicaid Percent	73.2%	85.0%
Percent of Occupancy (Acute)	5.6%	4.1%
Discharges (Exclusive of Swing-bed)		
Medicare	120	96
Medicaid	11	8
Private and other	52	21
	183	125
Average Length of Stay in Days	2.8	3.0

Independent Accountants' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
Story County Hospital and Long-Term Care Facility
Nevada, Iowa

We have audited the financial statements of Story County Hospital and Long-Term Care Facility as of and for the year ended June 30, 2006, and have issued our report thereon dated September 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings and responses as items 06-1 and 06-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described above are not a material weaknesses.

Twelve Wyandotte Plaza 120 West 12th Street, Suite 1200 Kansas City, MO 64105-1936 816 221-6300 Fax 816-221-6380

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Compliance with Certain Provisions of Iowa Law

The following comments about the Hospital's compliance with certain provisions of Iowa law for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our independent audit of the financial statements of the Hospital for the year ended June 30, 2006. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily examined. In addition, it should be noted that our audit was not directed primarily toward obtaining knowledge of compliance with the following items. Our procedures do not provide a legal determination on the Hospital's compliance with those requirements.

Official Depository Banks

A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2006.

Certified Budget

Budget hearings were held and publications were made in accordance with Chapter 24.9 of the Code of Iowa. Hospital disbursements during the year ended June 30, 2006 did not exceed amounts budgeted.

Questionable Expenditures

We did not note any questionable expenditures that we believe may constitute an unlawful expenditure from public funds or questionable disbursements that may not meet the public purpose requirements as defined in an Attorney General's opinion dated April 25, 1979. However, we noted that the Hospital did not have a formal policy for evaluating questionable expenditures.

Travel Expense

No expenditures of Hospital money for travel expenses of spouses of Hospital officials were noted.

The mileage reimbursement rate for employees, which should not be in excess of the IRS allowable limits, was not approved by the Board.

> Criteria or Specific Requirement – Board of Trustees is responsible for establishing and approving proper mileage reimbursement.
>
> Condition – Board of Trustees approval of mileage reimbursement rate was not documented.
>
> Context – Board of Trustees did not have an approved policy or resolution establishing the mileage reimbursement rate.
>
> Effect – Mileage reimbursement could be paid at unapproved rate.
>
> Cause – The Board of Trustees did not recognize the need to approve the mileage reimbursement in accordance with the provisions of Iowa law.
>
> Recommendation – The Board of Trustees should establish a policy to approve the mileage reimbursement rate on an annual basis to comply with Iowa law.

Business Transactions

We noted no transactions between Hospital and Hospital officials or employees other than those exempted by law; i.e., bankers on the Board of Trustees.

Trustee Minutes

No transactions were found that we believe should have been approved in the trustee minutes, but were not.

Deposits and Investments

We noted no instances of noncompliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Hospital's investment policy.

Unclaimed Property

Prior to November 1, 2005, the Hospital was required to file an annual report of unclaimed property with the state treasurer in accordance with Chapter 556.11 of the Code of Iowa. We noted the following exception:

Criteria or Specific Requirement – Hospital management is responsible for filing a report of unclaimed property or a negative report if no unclaimed property is on hand.

Condition – A report noting no unclaimed property was not filed in 2005 for the year ended June 30, 2004.

Context – The Hospital had no unclaimed property, but no report was filed.

Effect – Requirements were not met under Chapter 556.11 of the Code of Iowa.

Cause – Necessary reporting was not made in the current fiscal year.

Recommendation – Management should ensure necessary reporting is completed each year.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendations. Management will perform suggested action to ensure all reporting is made in accordance with the Code of Iowa.

Disbursements for Equipment and Supplies

We did not note any disbursements for equipment or supplies that we believe were not in accordance with Chapter 347.13(3) of the Code of Iowa.

Criteria or Specific Requirement – Hospital management is responsible for having a policy for procuring equipment under bidding and contracting requirements.

Condition – The Board of Trustees has not adopted a policy for procuring equipment under bidding and contracting requirements.

Context – A written policy is not in effect.

Effect – Requirements were not met under Chapter 347.13(3) of the Code of Iowa.

Cause – A written policy is not in place.

Recommendation – Management should establish a policy to set forth the requirements for procuring equipment under bidding and contracting requirements.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation. Management will perform suggested action to conform to this requirement.

Compensation of Hospital Administrator, Assistants and Employees

No instances were noted in which compensation for the administrator, assistants or employees was determined other than in accordance with Chapter 347.13(5) of the Code of Iowa.

Internal Revenue Service Information Returns and Outside Services

We noted no instances where the Hospital failed to properly prepare a Form 1099 for outside services of $600 or more or failed to properly classify workers as independent contractors versus employees.

* * * * * * *

This report is intended solely for the information and use of the governing body and management and the State of Iowa, and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
September 1, 2006

Story County Hospital and Long-Term Care Facility

Schedule of Findings and Responses

Year Ended June 30, 2006

Reference Number	Finding
06-1	Criteria or Specific Requirement—Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition—One individual has incompatible duties in the purchases and payroll cycles. Context—The individual responsible for processing cash disbursements and recording and monitoring payroll information has duties that include access to assets, recording responsibilities and some monitoring responsibilities. Effect—Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause—Duties in the purchases and payroll cycles are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation—Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions—Management concurs with the findings and recommendations. Management will perform suggested evaluation and make any changes that are cost effective and operationally feasible within the next year.
06-2	Criteria or Specific Requirement—Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition—Three individual positions have incompatible duties in the revenues and cash receipts accounting cycle. Context—The positions responsible for processing cash receipts and recording and monitoring revenue have duties that include access to assets, recording responsibilities and some monitoring responsibilities.

Story County Hospital and Long-Term Care Facility

Schedule of Findings and Responses

Year Ended June 30, 2006

Reference Number	Finding
06-2 (cont.)	Effect—Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause—Duties in the revenue and cash receipts accounting cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation—Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions—Management concurs with the findings and recommendations. Management will perform suggested evaluation and make any changes that are cost effective and operationally feasible within the next year.

BKD LLP

Board of Trustees
Story County Medical Center and
Long-Term Care Facility
Nevada, Iowa

As part of our audit of the financial statements of Story County Medical Center and Long-Term Care Facility (the "Hospital") for the year ended June 30, 2006, we studied and evaluated the Hospital's internal control structure. Because the study and evaluation was only part of the overall audit plan regarding the financial statements, it was not intended to be a complete review of all your accounting procedures and, therefore, would not necessarily disclose all reportable conditions or opportunities for improvement. A reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. We observed the following matters and offer these comments and suggestions.

Capital Assets

During the audit, we noted two fixed assets that were capitalized in 2006 that were under the Hospital's capitalization policy limit of $5,000. We also noted that some pharmacy equipment was capitalized during the year, but was inadvertently capitalized to the accumulated depreciation general ledger account. In addition, we noted the Hospital is using an older version of the American Hospital Association (AHA) guidelines for assigning useful lives for capital assets.

We recommend the Hospital follow its capitalization policy for capitalizing assets over its capitalization limit and when recording capital assets that the assets are recorded in the appropriate general ledger account. We also recommend that management use the current listing of the AHA's guidelines for assigning useful lives to depreciable assets.

Medicaid Contractual Allowance

At June 30, 2006, we noted that the contractual allowance account for Medicaid accounts receivable carried a debit balance and was unchanged from the prior year's balance. We suggest calculating an allowance specifically for Medicaid accounts receivable balances based on payment rates received during the year to accurately reflect the net realizable value of the Medicaid accounts receivable during the year and year end.

Bad Debt Allowance

During our review of the Hospital's allowance for bad debts, we noted the Hospital has not evaluated the percentages used in determining the estimated amounts recorded for uncollectible accounts in several years. We recommend the Hospital evaluate percentages used in determining the amount of uncollectible accounts during the year to verify that the percentages being used are accurate and provide the Hospital a basis for calculating the net realizable value of the accounts receivable.

Accounts Receivable Reconciliation

During testing of controls for receipts, we noted a reconciliation of accounts receivable to the general ledger is only performed at year end. We recommend this reconciliation be performed monthly.

Authorized Pay Rates

During testing of controls for payroll, we noted an employee was being paid a rate different from the authorized rate. We recommend the Hospital review the employee pay rates on a regular basis by either performing a monthly reconciliation between the Kronos time keeping system and the Dairyland accounting system or that monthly spot checks be performed on employee rates.

Journal Entry Review

During the review of manual journal entries, we noted the Chief Financial Officer (CFO) approved all journal entries including entries the CFO prepared. We recommend someone other than the preparer review manual journal entries.

EDP Password Policy

Current policies do not require user passwords to be changed on a regular basis throughout the year. Also, changes to user access and passwords for employees that change positions are not made. We recommend that you develop a formal policy to periodically change all passwords and to remove system access to areas when an employee changes duties and does not require access to areas any longer as a function of their new position and duties.

Adjustments at Year End

During the audit, we recommended adjustments be made to the accrued liability account for employee health insurance and to record a capital lease for equipment. These adjustments had a significant impact on the financial statements and should be recorded during the year to properly reflect the Hospital's financial position. We recommend the Hospital reconcile the accrued liability accounts on a monthly basis and evaluate any new leases for consideration of qualifying as a capital lease.

Risk Assessment Audit Standards

During the past year, the AICPA issued the Risk Assessment Suite of Standards (Statements of Auditing Standards Numbers 104 through 111). These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement in a financial statement audit and provide guidance on the design and performance of the audit procedures whose nature, timing and extent are designed to address the assessed risks. In addition, the Statements establish standards and guidance on planning and supervision, the nature of audit evidence and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion on the financial statements.

Overall, the primary objective of these Statements is to enhance the auditor's application of the audit risk model in conducting audits by specifying a more in depth understanding of the organization and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the organization is doing to mitigate the risks. These Standards are effective for fiscal years beginning on or after December 15, 2006.

These Standards will have a significant impact on the Hospital's audit once they become effective, which will most likely be June 30, 2008.

* * *

We appreciate the opportunity to present these comments and suggestions. This letter does not express an opinion on the Hospital's overall internal control structure; it does, however, include items that we believe merit your consideration. We can discuss these matters further at your convenience and provide any implementation assistance for changes or improvements you may require.

This letter is intended solely for the information and use of the Board of Trustees and management and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
September 1, 2006